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RR RUEHWEB

DE RUEHCH #1003/01 3641220
ZNR UUUUU ZZH
R 301220Z DEC 09
FM AMEMBASSY CHISINAU
TO SECSTATE WASHDC 8720

UNCLAS CHISINAU 001003

STATE FOR EUR/UMB, EUR/ACE, EEB/OMA

SENSITIVE
SIPDIS

E.O. 12958: N/A
TAGS: ECON EFIN EINV EREL ETRD MD
SUBJECT: ECONOMIC AND POLITICAL CRISES NECESSITATE
2009 BUDGET ADJUSTMENTS

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accordingly.

¶1. (SBU) SUMMARY: The previous Party of Communists (PCRM)-dominated Parliament adopted Moldova's initial state budget for 2009 with positive forecasts for GDP growth and receipts. However, the new government of Moldova (GOM) inherited a GDP drop of minus nine percent for 2009, falling revenues, and significant social expenditures maintained by the previous government during an election year. An October agreement with the IMF has provided some budget relief, helping the new GOM to temporarily cover the deficit. In addition, on December 3, the new Parliament amended the budget to reflect the new reality and reduce expenditures. The PCRM boycotted the vote, stating that it would not support cuts in social programs. END SUMMARY.

OPTIMISTIC ORIGINAL BUDGET PROJECTION

¶2. (U) The former PCRM-led GOM based its budget forecasts for 2009 on optimistic economic assumptions - six percent real GDP growth, single-digit inflation at 9.5 percent and a stable and strong exchange rate for the Moldovan Lei (MDL 9.12 per USD). However, the global economic crisis had a severe impact on the economy in Moldova. According to GOM data, GDP shrank by 7.6 percent in the first six months of 2009. The GOM projects that the overall GDP will be MDL 59.9 billion (USD 5.4 billion) in 2009, approximately nine percent less than in 2008.

BUDGET DIFFICULTIES IN 2009

¶3. (U) When the Alliance for European Integration (AIE) assumed power on September 25, it inherited a grim financial situation, with the budget deficit in the first nine months of 2009 reaching MDL 1.963 billion (USD 178 million). The state budget is heavily dependent on customs duties and Value Added Tax (VAT), which were adversely affected by the global economic crisis. In the first nine months of 2009, budget revenues were MDL 10.8 billion (USD 980 million), which equaled only 61 percent of the total annual revenue projection. During the first nine months of 2009, average budget revenues were only MDL 34.3 million per day, substantially less than the daily average of MDL 43 million for the same period in 2008.

¶4. (U) The budget projections also were affected by election year politicking, as the previous GOM

planned increased pensions and salaries for teachers and other government workers to woo voters. The drop in revenues forced the PCRM government to cut expenses for all sectors with the exception of support to the social insurance budget. In spring all ministries were instructed to reduce expenditures by 20 percent to ensure adequate funding for social programs. As a result, there are no arrears in social payments, including wages and pensions in Moldova. The PCRM has focused attention on its preservation of social payments during the economic crisis as a great success. However, the GOM was and continues to be behind schedule on reimbursements for VAT to Moldovan exporters. Local businesses report delays of over six months. The delay in VAT reimbursements actually means that the real budget deficit is much greater than the official figure.

IMF SUPPORT FOR THE BUDGET DEFICIT

¶5. (U) In late October, the GOM and the IMF reached preliminary agreement on a new economic program of USD 588 million. (Note: The previous GOM in June opted not to negotiate a new agreement with the IMF in light of the difficult conditions that the IMF would have required. IMF imposed measures were not welcome prior to parliamentary elections in July. End Note.) The agreement is subject to approval by IMF management and the IMF board, which will meet on the issue in January
¶2010. In addition, Moldova was able to use its

Special Drawing Rights (SDR) allocation from the IMF (equivalent to about USD 186 million) to cover its immediate budget deficit in November 2009. Under the IMF conditions, Moldova's budget deficit should not exceed seven percent of its GDP in 2010, five percent in 2011, and three percent in
¶2012. In addition to IMF budgetary support, the GOM is also raising funds with the sale of government securities (MDL 1.5 billion). (Septel will discuss additional conditions of the IMF agreement.)

AIE APPROVES BUDGET AMIDST PCRM BOYCOTT

¶6. (U) On December 3, the AIE-majority Parliament adopted an amendment to the 2009 budget which significantly reduced revenue by 26 percent from an initial projection of MDL 17.7 billion (USD 1.6 billion) to MDL 13.1 billion (USD 1.2 billion). Another amendment cut spending by 3.1 percent from MDL 18.3 billion (1.65 USD million) to MDL 17.7 billion (USD 1.6 million). The budget deficit was increased considerably from the original projection of MDL 574 million (USD 52 million) to MDL 4.65 billion (USD 420 million) - an increase of a factor of eight.

¶7. (U) The PCRM had submitted proposals to preserve much of the social spending increases planned previously by the PCRM government in committee meetings. The new GOM did preserve the provision of the previous PCRM-led GOM for a salary increase for teachers of 24 percent retroactive to September 1, 2009, but postponed other planned increases. Two further salary increases are planned for teachers on January 1, 2011 and September 1, 2011. Salary increases for all other government employees will not be considered before 2011. The PCRM then boycotted the voting on the amendments, arguing that it could not support cuts in social spending.

COMMENT

¶8. (SBU) The new GOM has taken practical steps to respond to the budget crisis, but will face the difficult challenge of living within its means while preparing for possible new parliamentary elections in fall 2010 (since the AIE was unable to elect a president in two rounds of voting this fall). In particular, the new GOM is keen to avoid cutting services, which could exacerbate social tension, and is counting on an economic upturn in its export markets in 2010. Perhaps more significantly, the government is hoping for economic growth in Russia, Ukraine, Italy and Portugal, where the largest concentrations of Moldovan guest workers are located. Remittances from Moldovans abroad continue to equal approximately one-third of GDP in Moldova.

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